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IN THE

Supreme Court of the United States

October Term, 1972

NO. 72-764

JAMES GRADY WALLER, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statement of the Case	3
Reasons for Granting the Writ	7
Conclusion	17
Appendix	
Indictment of the United States District Court for the Eastern District of Texas, Tyler Division	A-1
Judgment and Commitment of the United States District Court for the Eastern District of Texas, Tyler Division	A-4
Opinion of the Court of Appeals for the Fifth Circuit	A-6
Certificate of Service	A-11

CITATIONS

CASES:	Page
Baines v. United States, 426 F.2d 833 (5th Cir. 1970)	17
Bender v. Dingwerth, 425 F.2d 378 (5th Cir. 1970)	15
Blumberg v. United States, 222 F.2d 496 (5th Cir. 1955)	14
Clark v. Commissioner, 266 F.2d 698 (9th Cir. 1959)	9
Continental Casualty Co. v. First National Bank, 116 F.2d 885 (5th Cir. 1941), *cert. denied*, 313 U.S. 575	15
Farris v. Interstate Circuit, 116 F.2d 409 (5th Cir. 1941)	15
Ginsberg v. United States, 257 F.2d 950 (5th Cir. 1958)	14
Huff v. United States, 273 F.2d 56 (C.A. 5th 1959)	15
Marcus v. United States, 422 F.2d 752 (C.A. 5th 1970)	17
Massei v. United States, 241 F.2d 895 (1st Cir. 1957), *aff'd*, 355 U.S. 595 (1958)	14
Shephard v. Commissioner, 340 F.2d 27 (6th Cir. 1965)	9
Sherwin v. U. S., 320 F.2d 137 (9th Cir. 1963), *cert. denied*, 375 U.S. 964 (1963)	11
United States v. Bass, 425 F.2d 161 (7th Cir. 1970)	9, 11, 12
United States v. Spaulding, 293 U.S. 498, 306 (1934)	15
STATUTES:	
26 U.S.C. §7206(1)	1, 2, 3, 11, 17
28 U.S.C. §1254(1)	2
CONSTITUTION:	
United States Constitution, Amendment V	3, 18

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v.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, James Grady Waller, prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit whereby that court affirmed the judgment and sentence of the Federal District Court for the Eastern District of Texas whereby the Petitioner was found guilty of violating 26 U.S.C. Section 7206 on two counts and was sentenced to two successive eighteen-month sentences.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit has not yet been reported. It appears in the Appendix hereto (pp. A-6 - A-10).

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on October 27, 1972, and this petition for certiorari was filed within thirty days from such date. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

The questions presented by this case are as follows:

1. Was the decision of the Court of Appeals with respect to its sanction of the trial court's permitting the jury to consider whether the Taxpayer intentionally omitted income from his return by not reporting certain "constructive dividends", determined to be so only by the conclusions and opinion of the Government's own witness an erroneous application of 26 U.S.C., Section 7206?

2. Was the district court's admission of a massive amount of evidence which was not probative of the ultimate facts sought to be established and also creative of a prejudicial attitude against the Defendant a departure from the accepted and usual course of judicial proceeding which denied the Defendant due process of law?

3. Was the district court's allowing testimony by a Government accountant on points of law and to express opinions and conclusions on the ultimate questions for the jury a departure from the accepted and usual course of judicial proceeding which deprived the Defendant of his right to due process of law?

4. Did the cumulative error at the trial result in the Taxpayer not having a fair trial on the charges made

in the indictment which was a deprivation of due process of law in violation of the Fifth Amendment to the Constitution of the United States?

STATEMENT OF THE CASE

Defendant-Petitioner (hereafter referred to as the "Defendant" or "Taxpayer") was convicted of two counts (1966 and 1967) of filing income tax returns in violation of Section 7206(1) of the Internal Revenue Code of 1954 and was sentenced to two successive terms of confinement of eighteen months on each count (Appendix, p. A-4).

The indictment (Appendix, p. A-1) charged the Defendant with having filed his 1966 and 1967 income tax returns knowingly and willfully omitting income from three sources: gross receipts from Waller Funeral Home (an unincorporated business) and "dividends" from Crockett National Life Insurance Company and the State National Bank of Lovelady, two corporations principally owned by Taxpayer, and in 1967 only, the further allegation of the omission of certain commissions allegedly earned by negotiating and entering loans for State National Bank of Lovelady.

An elaborate stipulation was entered into by the parties concerning evidentiary details of the receipts of the Taxpayer's funeral home business, on a funeral-by-funeral basis, for each of the two taxable years involved. (Cir. Ct. Appendix, p. 526.) A similar stipulation was entered into by the parties concerning the authenticity of documents, such as checks, receipts, and the like, bearing on payments to the funeral home business. (Cir. Ct. Appendix, p. 595.) In addition, the Government offered testimony by sixteen witnesses concerning payments made by

them for funerals performed by the Taxpayer. (Cir. Ct. Appendix, pp. 964-1060.) Counsel for the Taxpayer had indicated in the opening statement that some error did exist in the funeral home receipts as reported, but that such mistakes were without the Taxpayer's knowledge, sanction or condonation. (Cir. Ct. Appendix, p. 30.) The Government contended that the Taxpayer had engaged in a so-called banking "scheme", to avoid accurate reflection of his funeral home receipts arguing that the evidence it would present with regard to Taxpayer's irregular banking habits was relevant because it showed Taxpayer's intent to omit the income. (Cir. Ct. Appendix, pp. 87-88.) The Government then offered voluminous testimonial and documentary evidence concerning the Taxpayer's practice of drawing checks in the name of "Waller Funeral Home" (made by either the Taxpayer directly or his employee, Mae Belle Stepleton) on the Farmer's Guaranty State Bank of Kennard, Texas, depositing such checks to the account of Waller Funeral Home at the First National Bank of Crockett (which account was admittedly used only for the payment of expenses about which there was no issue in the case), having such checks held by the Farmer's Guaranty State Bank in their cash items, and thereafter "redeeming" or "purchasing" such checks with cash or third-party checks. Substantial parts of the testimony of a number of witnesses together with many documents from the records of First National Bank of Crockett, Farmer's Guaranty State Bank of Kennard and State National Bank of Lovelady dealt with the banking practice of the Taxpayer. Although the authenticity of the documentary evidence was admitted by the Taxpayer, the evidence was received over the Taxpayer's objections as to its materiality and relevancy and by reason of its preju-

dicial effect. (*E.g.*, Cir. Ct. Appendix, pp. 186, 267, 269, 276, 282, 283, 286.) The Taxpayer moved to strike all of such evidence, which motion the District Court denied after hearing argument thereon. (Cir. Ct. Appendix, pp. 10-17, 1593-94, 1894-1910, 67.)

In his opening statement the prosecuting attorney began a pattern of characterizing the Taxpayer's bank overdrafts as "hot checks." In examining the witness John N. Morgan, the prosecuting attorney sought to have him characterize the Taxpayer's checks at the Farmer's Guaranty State Bank of Kennard as being "hot checks," and, after appropriate voir dire questions, the Taxpayer objected to such characterization (Cir. Ct. Appendix, pp. 270-72), but thereafter the prosecuting attorney continued to refer to the checks as "hot checks." (Cir. Ct. Appendix, pp. 945-46, 1096.) Furthermore, the witness Morgan, the president of the Farmer's Guaranty State Bank of Kennard, not only testified that he agreed to the banking procedure in question, but that it had been their practice (the bank's and the Taxpayer's) since 1953 and that they were still banking in the same manner.

The Government alleged that three separate payments were made to the Taxpayer by the Crockett National Life Insurance Company constituting constructive dividends. (Cir. Ct. Appendix, pp. 93-94.) The Government offered proof that the three checks were signed by Taxpayer, taken by him, ended up at the State National Bank for negotiation, and were designated on the books of the insurance company as death benefits paid by reason of the deaths of Tod Adams, J. L. McDaniel and H. E. Gibson. (Cir. Ct. Appendix, pp. 1085, 1142-1155, 1208, 1220-21, 1224-25.) Over the objections of the Taxpayer (Cir. Ct. Appendix, pp. 1212-17) that the evidence was collateral,

cumulative, and that any probative value was far outweighed by the attending prejudicial effect on the jury's ability to try the Taxpayer for the crimes charged, the Government was permitted to offer proof seeking to establish that the H. E. Gibson, Tod Adams and J. L. McDaniel death claims were based on altered or forged documents such as credit life applications, credit life policies and/or bank notes.

The Government called as its final witness Mr. Marcus Henry, an Internal Revenue agent, whom it qualified as an expert in accounting matters. Mr. Henry was permitted to summarize all the other evidence in the case and to express conclusions and opinions as to the remaining issues, such as receipt by Taxpayer of constructive dividends, whether he owed a debt to the bank, and the like. (Cir. Ct. Appendix, pp. 1529-30.) Counsel for the Taxpayer objected to such utilization of the Government's summary witness to continue summarizing non-accounting information (Cir. Ct. Appendix, pp. 1539-40), and at the conclusion of the witness's testimony moved the District Court to strike such testimony (Cir. Ct. Appendix, p. 1594). The District Court overruled the objection (Cir. Ct. Appendix, p. 1540), denied the motion (Cir. Ct. Appendix, p. 2033) and declined to instruct the jury, although requested to do so by the Taxpayer, that the court's general charge on expert testimony be supplemented by a specific instruction that Mr. Henry's opinions and conclusions on ultimate issues be disregarded by the jury. (Cir. Ct. Appendix, pp. 2029-30, 2033.)

As an item of constructive dividend out of State National Bank in 1966 (covered by Count One of the indictment), the Government claimed that the State National Bank charged off as a bad debt a note for which the

Government contended the Taxpayer was allegedly responsible. The Government's evidence showed that two persons named Holt and Bobbitt executed a note in the name of H & B Motors, Incorporated, at the request of the Taxpayer, although to their knowledge there was no such company. The Taxpayer testified that he utilized the note in question as a method of accounting for repossessed cars, by putting them on such a note and crediting the note as cars were sold. Any balance remaining after the last car was sold would be charged off. (Cir. Ct. Appendix, pp. 1674-78.) With regard to the note there was no evidence that the Taxpayer received any money, property or benefits, such as a release of any liability for which Taxpayer was responsible. The Taxpayer objected to the submission of this issue to the jury on the evidence (Cir. Ct. Appendix, pp. 2028-29), but the objection was overruled (Cir. Ct. Appendix, p. 2033).

In a motion for new trial filed after the verdict, the Taxpayer urged, among other grounds, that the cumulative effect of errors at the trial was such as to deny him a fair trial. (Cir. Ct. Appendix, p. 63.)

Defendant timely filed his notice of appeal to the Fifth Circuit Court of Appeals, briefs were filed and oral argument heard October 5, 1972. On October 27, 1972, the court affirmed the judgment of the lower court (Appendix, p. A-6).

REASONS FOR GRANTING THE WRIT

The qualifications for review on certiorari, as specified in Rule 19 of this Court, are abundantly and compelling fulfilled by the case at bar.

1. The decision of the court of appeals with respect to its sanction of the trial court's permitting the jury to consider whether the Taxpayer intentionally omitted income from his return by not reporting certain "constructive dividends", determined to be so only by the conclusions and opinion of the Government's own witness, is an important question of federal law which has not been, but should be, settled by this court.

The trial court allowed the jury to consider two types of transactions, described by the Government as a "constructive dividend", as being income which the Taxpayer could have knowingly omitted from his return. The character of the transactions were proceeds of insurance policies which were contended to be received by Taxpayer from his wholly-owned corporation, Crockett National Life Insurance Company, and the cancellation of a note by State National Bank of Lovelady, principally owned by Taxpayer.

The contention by the Government that a Taxpayer could knowingly and willfully omit a "constructive dividend" in the present case is completely without merit since the act is not conceptually possible. The Government, by the testimony of a still different Revenue Agent, attempted to show that the Crockett National Life Insurance Company had earnings and profits for 1966 (Cir. Ct. Appendix, pp. 1348-1377) so that any distribution from the company could be deemed to be a dividend. Then the accounting witness for the Government, concluding that earnings and profits existed, opined that any distribution from the company to Defendant would be a "constructive dividend." In answer to the Government's expert

on earnings and profits, Defendant called a certified public accountant with the firm of Ernst and Ernst who testified that the insurance company had no earnings and profits, in fact had a deficit. (Cir. Ct. Appendix, pp. 1821-1855).

The very term constructive dividend implies the doubt as to the character of payment. The term is used extensively in civil tax cases dealing with corporate distributions which in the opinion of the Government is distribution of the corporation's earnings and profits in a form other than a formally declared dividend. See, *e.g.*, *Clark v. Commissioner*, 266 F.2d 698 (9th Cir. 1959); *Shephard v. Commissioner*, 340 F.2d 27 (6th Cir. 1965). To use the term in a criminal case, to consider in this case the irreconcilable testimony of the expert accounting witnesses of the respective parties with regard to the earnings and profits of Crockett National Life Insurance Company, creates prima facie doubt as to whether Taxpayer could have willfully omitted the so-called constructive dividends, knowing he should have reported them. Furthermore, it shifted the burden of proving that the insurance company did *not* have earnings and profits—an effect expressly prohibited in a criminal case. *United States v. Bass*, 425 F.2d 161 (7th Cir. 1970).

In addition to the error of the trial court's allowing the jury to consider Taxpayer's intent of omission with regard to distributions from the insurance company, there was also error in allowing the jury to consider the so-called Holt-Bobbitt note charge-off by the State National Bank of Lovelady, Texas as a distribution of a benefit to Taxpayer which could be construed to be a dividend which Taxpayer should have known he was to report on his 1966 income tax return.

The Taxpayer testified that the bank utilized the note in question as a method of accounting for repossessed cars by internally, solely within the bank, creating one note for several defaulted notes and securing the note by the repossessed automobiles. When the repossessed automobiles were repaired, restored and sold, the proceeds were applied against the one note and the remainder of the note was charged off by the bank. The net effect of the transaction was the same as if the several defaulted notes were charged off at the time of the repossession.

There was no evidence that the Taxpayer received any money, property or other value incident to the making of the note, that he signed the note as a co-maker, guarantor, or otherwise, or that he was ever legally released or discharged from any liability he might have had on the note. The Taxpayer objected to the submission of this issue to the jury on this state of the evidence (Cir. Ct. Appendix, pp. 2028-29), but the objection was overruled. (Cir. Ct. Appendix, p. 2033.)

For there to be a dividend, it is obvious that the alleged recipient thereof must have received something of value from the corporation paying the dividend. There was no evidence that the Taxpayer got any payment or other thing of value incident to the execution of the note in question. There was no evidence upon which it could reasonably be determined that the Taxpayer was personally responsible to the bank on the note.

The only evidence the Government presented in such respect was the specious reasoning of the Government's expert accountant (Cir. Ct. Appendix, pp. 1571-1572) which in summary was: That Holt and Bobbitt were not liable for the note they signed; therefore, since they were

presented the note by Defendant, he must be liable; therefore since the bank he controlled charged it off, he must have received a benefit; therefore, since the bank had earnings and profits, Defendant received a dividend; *and he should have known to report it on his 1966 income tax return.*

On such opinion evidence the jury should not have been allowed to consider the question of willfull omission and it was an error for the court to submit Count One to the jury. It is self-evident that before the Defendant could have known to report any amount as income, or "constructive dividend" or whatever the Government wants to label its theory, there must be a showing that the Defendant received something of value. *Sherwin v. U. S.*, 320 F. 2d 137 (9th Cir. 1963), *cert. denied* 375 U.S. 964 (1963). The judgment of conviction as to Count One ought to be reversed on that ground and a new trial ordered.

It is not here contended that as a matter of law the Government is precluded from alleging a Section 7206 (1) violation unless there is a formally declared dividend which was omitted, but the question to be decided in a Section 7206(1) case is the state of mind of the taxpayer when he receives the benefit alleged to come from the taxpayer's corporation. In the present case the jury was allowed to consider whether Defendant intentionally omitted a dividend when there was substantial controversy over whether there could have been a dividend, and further, allowed to consider Defendant's intention of omitting a dividend *when there was no evidence that he received it.* Such action simply had the effect of converting a civil tax case into a criminal matter. See, *United States v. Bass,*

supra. The net effect of the trial court's submission of the foregoing transactions for consideration by the jury is simply an overextension of the boundaries of Section 7206 (1) which the Court of Appeals apparently sanctioned (Appendix, p. A-6).

2. The sanction by the Court of Appeals of the lower court's admission of a massive amount of irrelevant evidence which was not probative of the ultimate facts sought to be established and also creative of a prejudicial attitude against the Defendant, so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this court's power of supervision.

Throughout the trial the Government persisted in its introduction of evidence to which the Defendant continually objected on the grounds of relevancy and to the prejudicial effect against the Defendant obviously being affected by the admission of the evidence.

In a Section 7206 case, the Government has the unquestionable right to show that the Defendant handled many business transactions in cash and cash-like items. However, giving the reason that the Government had to prove Defendant's intention of omission of taxable income, which was obvious since such intention is an element of the alleged crime, the Government launched into the development of the Defendant's banking practice as a "scheme", imputing throughout the trial bad conduct to the Defendant by referring to checks he wrote as "hot checks" (Cir. Ct. Appendix, pp. 88, 270, 945-46, 1096), and "no good" and "bad checks" (Cir. Ct. Appendix, pp.

1917, 1922). The Court of Appeals condoned this action by saying:

> The prosecutor's allusion to the "check" documents as "hot checks", if indeed inaccurate at all, was not so clearly improper as to constitute error. More apt descriptions of these items as "bogus" or "fictitious" checks might have increased the possibility of prejudice. (Appendix, p. A-9.)

This statement completely ignores the testimony of the president of the drawee bank, Mr. John N. Morgan who stated that he was aware of the procedure (since 1953), and approved of it. When such an agreement is made with a president of a bank, it is inconceivable how such checks could be termed "hot checks", or even "bogus" or "fictitious" checks as characterized by the court. The checks amounted to no more than short-term loans by agreement with the bank.

Again, with respect to the so-called "constructive dividend" from Crockett National Life Insurance Company, the Government had the unquestioned right to show that Taxpayer received cash or some other benefit from the corporation, but the Government failed to stop at this point. The Government offered evidence to attempt to show that certain life insurance policies were "suspicious" and even put on extensive demonstrative evidence from a Government examiner of documents. (Cir. Ct. Appendix, pp. 1302-1326.) In oral argument in the Court of Appeals, counsel for the Government said the Government did not necessarily intend to show the Defendant as the person responsible for the alleged "forgeries." What, then, was the relevance of any such proof? There was no purpose but to impute irregular conduct to the Defendant to effect an atmosphere of prejudice against him.

The irrelevance of the evidence offered is one reason to reverse the trial court. *Blumberg v. United States,* 222 F.2d 496 (5th Cir. 1955); *Ginsberg v. United States,* 257 F.2d 950 (5th Cir. 1958). The intentionally created prejudicial effect of the evidence is another. See *Massei v. United States,* 241 F.2d 895 (1st Cir. 1958), *aff'd* 355 U.S. 595 (1958).

3. The decision by the Court of Appeals with regard to the lower court's allowing testimony by a Government accountant on points of law and to express opinions and conclusions on the ultimate questions for the jury so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's power of supervision.

The Government offered an agent trained in accounting as a "summary" witness. The agent, without objection by the Taxpayer, summarized the mass of testimony and other evidence pertaining to the receipts of the funeral home business from burials conducted during the two indictment years. He then expressed his conclusion as to the total amount of such gross receipts as shown by the evidence summarized by him. (Cir. Ct. Appendix, pp. 1462-1529.)

Upon further questioning, the witness was then permitted to summarize other evidence in the case bearing on non-accounting issues and to express conclusions and opinions as to those issues. (Cir. Ct. Appendix, pp. 1529-30.) Objection was made on behalf of the Taxpayer to the utilization of such a witness to continue summarizing such non-accounting information (Cir. Ct. Appendix, pp. 1539-40) and at the conclusion of the witness's testi-

mony, motion was made on behalf of the Taxpayer to strike all such testimony on non-accounting issues. (Cir. Ct. Appendix, p. 1594.) The trial court overruled the objection (Cir. Ct. Appendix, p. 1540) and denied the motion. (Cir. Ct. Appendix, p. 2033.) The witness proceeded to give purported expert testimony on certain legal elements of constructive dividends and conclusions with regard to alleged corporate distribution to Taxpayer.

This Court has held that it is not proper for an expert witness to state his conclusions on the whole case. In dealing with the question of whether the plaintiff in a case suffered a total disability, this Court held that it is not to be resolved by opinion evidence. "It was the ultimate issue to be decided by the jury upon all the evidence in obedience to the judge's instructions as to the meaning of the crucial phrase and other questions of law." *United States v. Spaulding,* 293 U.S. 498, 306 (1934). The Fifth Circuit Court of Appeals has had occasion to apply a similar rule, both in applying state law and in federal question matters. See, *Bender v. Dingwerth,* 425 F.2d 378 (5th Cir. 1970); *Continental Casualty Co. v. First National Bank,* 116 F.2d 855 (5th Cir. 1941), *cert. denied,* 313 U.S. 575; *Huff v. United States,* 273 F.2d 56 (C.A. 5th, 1959); *Farris v. Interstate Circuit,* 116 F.2d 409 (5th Cir. 1941). *Huff v. United States* involved an alleged customs violation. The controlling statute contained exemptions from duty for items of jewelry that constituted "personal effects." The Government called a customs inspector who testified in a fashion analogous to that of the Government summary witness in the current case. This Court reversed the conviction, saying (p. 61):

> Over the defendant's objection, the district court permitted the Government witness, Herman Charry,

a Supervisory Customs inspector with 28 years experience, to testify to his construction and interpretation of the custom laws, statutes, rules and regulations and to give his opinion that the jewelry found in the possession of the defendant was of a commercial nature rather than personal effects.

Of course, the Government cannot in this manner be permitted to substitute its witness for the Court in charging the jury as to the applicable law. 7 Wigmore on Evidence, 3rd ed. Section 1952. Nor was the witness' opinion and conclusion admissible as to one of the ultimate facts to be decided by the jury. *Mack v. United States,* 5 Cir., 1959, 268 F.2d 931, 934. This testimony was highly prejudicial, and the error in its admission necessitates a reversal of the judgment of conviction on Count 1 as well as on Count 2.

The prejudice to the Taxpayer is clear, for there is a special danger of the testimony of the summary witness being accepted as authentic, primary proof. Moreover, it is a clear situation of the prosecution being allowed an unfair advantage of twice making its closing argument in the case. On this ground, the judgment of conviction ought to be reversed and a new trial ordered.

4. The cumulative effect of error made at the trial and sanctioned by the Court of Appeals resulted in the Taxpayer not having a fair trial on the charges made in the indictment and so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's power of supervision.

Each one of the errors discussed in the foregoing Reasons For Granting the Writ was prejudicial to the De-

fendant's right to be fairly tried on the issues laid in the indictment. The sum of those errors had the further effect of denying to the Taxpayer his right to be fairly tried on the issues for which he stood indicted. We urge this Court, as we urged the lower courts to look to the aggregate of the errors to determine whether the cumulative effect of such rulings was to deny the Defendant a fair trial. If so, even though particular errors might not require a reversal in and out of themselves, if the cumulative effect is to deny the Defendant a fair trial, the judgment of conviction should be reversed. See, *Baines v. United States*, 426 F.2d 833 (5th Cir. 1970), *Marcus v. United States*, 422 F.2d 752 (C.A. 5th 1970).

CONCLUSION

The decision below departs radically from both substantive and procedural judicial precedent. The matters involved are of extreme general and national significance. Questions are presented which have not been, but should properly be, conclusively determined by this Court.

The Defendant was convicted for omitting fictitious "income." Even if the Defendant received a benefit from one of his corporations, the status of that benefit as income was so tenuous that prima facie doubt as to whether Defendant knew he was omitting had to exist. The federal district court's allowing the jury to consider the "constructive dividends" in the present case simply enables the Government, at its will, to convert any civil income tax case into a criminal case under 26 U.S.C. §7206(1).

The federal district court's admission of the irrelevant and prejudicial evidence of alleged misconduct of the De-

fendant, not in any way related to the charges in the indictment as well as the cumulative effect of all errors committed by the federal district court, violate the Defendant's right to a fair trial pursuant to the Fifth Amendment of the United States Constitution.

All of the reasons listed above are, therefore, most strenuously urged as basis for this Court's exercise of discretion in granting of the writ.

Respectfully submitted,

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APPENDIX

IN THE

United States District Court

FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

CRIMINAL ACTION NO. 7115

UNITED STATES OF AMERICA
VS.
JAMES GRADY WALLER

INDICTMENT

(Filed September 10, 1970)

Vio. Ti. 26, U.S.C., Sec. 7206(1) (Not more than $5,000 or not more than three years, or both)

THE GRAND JURY CHARGES:

COUNT I.

That on or about the 15th day of April, 1967, in the Eastern District of Texas, James Grady Waller, a resident of Crockett, Texas, did willfully and knowingly make and subscribe a joint income tax return for the calendar year 1966, which was verified by a written declaration that it was made under penalties of perjury and was filed with the District Director at Dallas, Texas, which said income

tax return for the calendar year 1966 he did not believe to be true and correct as to every material matter in that the said 1966 income tax return reported: (a) Waller Funeral Home Receipts, less returns and allowances, of $144,967.00; (b) dividends from State National Bank of Lovelady in the sum of $20,000.00; and, (c) no dividends from the Crockett National Life Insurance Company, whereas, as he then and there well knew and believed: (a) that the Waller Funeral Home Receipts were greater than the amount reported; (b) that he had dividends from State National Bank of Lovelady in the sum of $24,-648.00; and, (c) that he had received dividends of $3,000 from the Crockett National Life Insurance Company, in violation of Section 7206 (1), Internal Revenue Code and Title 26 United States Code, Section 7206(1).

Vio. Ti. 26, U.S.C., Sec. 7206(1) (Not more than $5,000 or not more than 3 years, or both)

COUNT II.

That on or about the 13th day of April, 1968, in the Eastern District of Texas, James Grady Waller, a resident of Crockett, Texas, did willfully and knowingly make and subscribe a joint income tax return for the calendar year 1967, which was verified by a written declaration that it was made under penalties of perjury and was filed with the District Director at Dallas, Texas, which said income tax return for the calendar year 1967 he did not believe to be true and correct as to every material matter, in that the said 1967 income tax return reported: (a) Waller Funeral Home receipts, less returns and allowances, of $174,709.00; (b) no dividends from the Crockett National Life Insurance Company; (c) no monies

acquired in the process of negotiating and entering loans at the State National Bank of Lovelady; (d) dividends from State National Bank of Lovelady in the sum of $4,100.00, whereas, he then and there well knew and believed: (a) that the Waller Funeral Home receipts were greater than the amount reported; (b) that he had received dividends from the Crockett National Life Insurance Company of $5,200.00; (c) that he received monies from the negotiation and entering of loans at the State National Bank of Lovelady of $1,600.00; and (d) that he received dividends from State National Bank of Lovelady in the sum of $7,440.45, in violation of Section 7206(1), Internal Revenue Code, and Title 26, United States Code, Section 7206(1).

A TRUE BILL.

/s/ CHARLES C. DELTON
Foreman

/s/ ROBY HADDEN
ROBY HADDEN
United States Attorney

/s/ JAMES W. KNOWLES
JAMES W. KNOWLES
Assistant U. S. Attorney

A-4

JUDGMENT AND COMMITMENT

(Filed September 30, 1971)

On this 30th day of September, 1971, came the attorney for the government and the defendant appeared in person and by counsel, Robert Waters, Esq., of Houston, Texas, and Fred Erisman, Esq., of Longview, Texas.

IT IS ADJUDGED that the defendant upon his plea of NOT GUILTY and a Jury Verdict of GUILTY entered on August 12, 1971, has been convicted of the offense of willfully and knowingly filing a joint income tax return for the calendar year 1966, which he did not believe to be true and correct, as set out in Count 1; and the offense of willfully and knowingly filing a joint income tax return for the calendar year 1967, which he did not believe to be true and correct, as set out in Count 2, in violation of Title 26, United States Code, Section 7206(1), as charged in the two count indictment and the court having asked the defendant whether he has anything to say why judgment should not be pronounced, and no sufficient cause to the contrary being shown or appearing at the Court,

IT IS ADJUDGED that the defendant is guilty as charged and convicted.

IT IS ADJUDGED that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of EIGHTEEN (18) months as to Count 1 and EIGHTEEN (18) months as to Count 2. The sentence imposed herein as to Count 2 of the Indictment shall be cumulative to the sentence imposed as to Count 1.

It is further ADJUDGED that the defendant shall be eligible for parole at such time as the U.S. Board of Parole shall determine, under Title 18, United States Code, Section 4208 (a) (2).

APPROVED AS TO FORM:

/s/ JAMES W. KNOWLES
JAMES W. KNOWLES, AUSA

IT IS ORDERED that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the copy serve as the commitment of the defendant.

/s/ WM. WAYNE JUSTICE
United States District Judge

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 71-3381

UNITED STATES OF AMERICA, *Plaintiff-Appellee,*

versus

JAMES GRADY WALLER, *Defendant-Appellant.*

Appeal from the United States District Court for the Eastern District of Texas

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(October 27, 1972)

Before GEWIN, THORNBERRY and CLARK, Circuit Judges.

PER CURIAM: James Grady Waller was convicted of the white collar crime of wilfully signing and filing false income tax returns in violation of 26 U.S.C.A. §7206(1).[1]

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1. Any person who—
(1) *Declaration under penalties of perjury.* — Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter;
* * *

shall be guilty of felony and, upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution.

Waller now asserts that the trial court erred in allowing the government to prove both too much and too little. Waller at first contended that since wilful false filing would suffice to carry the government's burden, the admission of proof of the full details of his long-continued, unusual fiscal and accounting practices was unduly prejudicial. In a supplemental brief with new counsel, Waller faults the government for failing to adduce evidence showing that he believed his returns were false. Additional trial errors are asserted relative to (1) the prosecutor's characterization of certain checks drawn on a non-existent account as "hot checks", (2) an expert witness's statement of opinion that funds withdrawn from his controlled corporation amounted to a constructive dividend, (3) the admission of evidence of similar transactions in tax years not covered in the indictment, and (4) the cumulative impact of these errors. We affirm.

The proof disclosed that Waller made a continuous practice over the course of several years of depositing instruments having every indicia of regular checks in the local bank account of his funeral home business. However, these "checks" were drawn on a bank in which the drawer had no account. Under a regular practice, the drawee bank never handled these items in the regular course of business but, instead, held them in suspense until Waller redeemed such paper with cash or its equivalent. The proof further disclosed that funeral home employees were instructed to consistently omit certain funeral charges from bookkeeping records of the funeral home. Although some of this evidence related to dates and events outside the tax years covered by the indictment,

all of it was admissible for the purpose which the court carefully instructed the jury to confine it to — proof of an intent to file a tax return which was known to be false. Counsel for Waller contends that this proof carried such slight probative weight for its intended purpose and such a high risk of unjustly casting Waller as a bad man in the jury's mind, that its allowance was an abuse of discretion. We do not agree. Waller's trial defense from its outset asserted that any omissions from his tax returns were due to inadvertance or careless business practices and sloppy accounting methods. The government could certainly meet this contention with the facts it showed. The portions of the proof touching events in other periods related to practices which were both current to the tax periods covered in the indictment and continuous. Such proof was probative and properly limited. We reject Waller's assertion that the government overprooved its case.

Having concluded that all of this evidence was admissible for the purpose of proving that Waller filed the subject returns wilfully and knowingly, believing them to be false, we are next met with the inconsistent contention that the government failed to carry its burden of establishing the guilty belief. However, the jury was entitled to infer that Waller's long-continued course of conduct, which was so far different from ordinary business practice and so deceptive in its accounting result, was done to purposefully and intentionally avoid detection of income and to support false filings. Thus, we likewise reject the contention that the government failed to carry its burden of adducing sufficient evidence to support the jury's verdict.

The prosecutor's allusion to "check" documents as "hot checks", if indeed inaccurate at all, was not so clearly improper as to constitute error. More apt descriptions of these items as "bogus" or "fictitious" checks might have increased the possibility of prejudice.

The government expert, Henry, summarized his accounting findings relative to distributions made to Waller from two controlled corporations and characterized these payments as constructive dividends. Although Waller's counsel at one point indicated that he had no objection to the characterization if the court covered the point in its instructions, he did later insist that Henry's testimony in this regard was prejudicial error. We disagree. The opinions did not invade the province of the jury. Waller was on trial for knowingly filing false tax returns. Whether the omitted items of income were constructive dividends or other types of payments was immaterial.

Relying upon our decision in *Baines v. United States,* 426 F.2d 833 (5th Cir. 1970), Waller asserts that the proof of transactions in years other than those specifically covered by the indictment, was error which placed on him a duty to defend himself against charges for which he was not being tried. In *Baines* the court was careful to note:

> Because of the closeness of the case the Court feels compelled to hold, as we held in Marcus v. United States, 5 Cir. 1970, 422 F.2d 752, "that the cumulative effect of the District Court's errors, which are discussed in detail below, when taken together, require that this case be reversed and remanded to the District Court for a new trial, even though no single error, when viewed in isolation would necessarily

require this disposition. See Getchell v. United States, 5 Cir., 1960, 282 F.2d 681, 691." We limit our holding to the facts peculiar to this rare case involving the failure to pay federal cabaret excise taxes.

The case is distinguishable here. Although the proof in the case at bar might have suggested that returns for prior years were inaccurate, no contention was ever made that other false filings resulted. This case falls squarely under *Jernigan v. United States*, 411 F.2d 472 (5th Cir. 1969), which approved the procedure of proving repetitious practices extending into years other than those covered by the indictment to show intent and to negate innocent inadvertence.

We have reviewed the asserted errors individually and collectively, and neither singly nor cumulatively was the trial court incorrect in entering its judgment of conviction.

AFFIRMED.

IN THE

Supreme Court of the United States

October Term, 1972

NO._____

JAMES GRADY WALLER, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

CERTIFICATE OF SERVICE

I hereby certify that in accordance with Rule 33 of the Rules of this Court, on the 22nd day of November, 1972, three copies of the Petition for Writ of Certiorari were mailed, air mail, postage prepaid, to the Solicitor General, United States Department of Justice, Washington, D. C. 20530, and three additional copies to Mr. Roby Haddon, United States Attorney, P. O. Box 1049, Tyler, Texas 75701. I further certify that all parties required to be served have been served.

Mary Jo Carroll

MARY JO CARROLL
P. O. Box 1148
Austin, Texas 78767
Counsel for Petitioner

In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-764

JAMES GRADY WALLER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

After a jury trial in the United States District Court for the Eastern District of Texas, petitioner was convicted on two counts of having willfully made and subscribed individual income tax returns which he did not believe to be true and correct as to every material matter, in violation of 26 U.S.C. 7206(1) (R. 7-10).[1] He was sentenced to two consecutive 18-month prison terms, with immediate parole eligibility under 18 U.S.C. 4208(a)(2) (R. 65-66).

Petitioner owned a controlling interest in the Crockett National Life Insurance Company and the State National Bank of Lovelady (Pet. 3). He also

[1] "R." refers to the appendix filed in the court of appeals.

492-346

operated the Waller Funeral Home as a sole proprietorship. After substantial evidence had been introduced showing that petitioner's income tax returns had understated the income of the funeral home, an expert witness testified for the government that in his opinion the total of such understatements for the two prosecution years, 1966 and 1967, was $21,018 (R. 1468–1508) and $24,027 (R. 1509–1528), respectively.[2] Although the understatements of income from the funeral home constituted the bulk of the government's proof, there was also evidence to show that petitioner had received disbursements and indirect payments from the two corporations which he controlled, the Crockett National Life Insurance Company and the State National Bank of Lovelady, without reporting those items as income (R. 1536–1553).[3]

1. There is no substance in the argument (Pet. 8–12) that the evidence relating to the corporate distributions, or "constructive dividends," should not have gone to the jury. After the expert witness explained in detail the meaning of the phrase "constructive

[2] The understatements resulted from the omission of several individual items of income. Petitioner admitted on the witness stand that he had not brought these omissions to the attention of the accountant who prepared the tax returns and that he had instructed his bookkeeper not to record these items (R. 1686–1689, 1777, 1796).

[3] Non-salary distributions of this kind, when made to corporate shareholders, constitute taxable dividends to the extent that they are paid out of earnings and profits (see *e.g.*, *Regensburg* v. *Commissioner*, 144 F. 2d 41 (C.A. 2)), and the evidence established that petitioner's corporations had sufficient earnings and profits to cover the distributions made to him (R. 1348–1377, 1540).

dividends," defense counsel stated that he had no objection to further testimony on that issue provided that the court would, in its instructions, define what legally constitutes a constructive dividend (R. 1532). Such instructions were given (R. 2017–2019).

Petitioner is incorrect in now suggesting (Pet. 9) that proof of constructive dividends is appropriate only in civil tax cases and has not been used in criminal cases. Many criminal tax convictions have rested entirely, and others primarily, on proof of the receipt of unreported constructive dividends. See, *e.g.*, *United States* v. *Wallace*, 300 F. 2d 525 (C.A. 4); *United States* v. *Keenan*, 267 F. 2d 118 (C.A. 7), certiorari denied, 361 U.S. 863; *Currier* v. *United States*, 166 F. 2d 346 (C.A. 1). Whether petitioner knew that his constructive dividends should have been reported on his tax returns was a question of fact for the jury, and petitioner does not contend that the jury was improperly instructed as to this question.[4]

2. Petitioner contends (Pet. 12–14) that the government's evidence pertaining to his banking practices was irrelevant and prejudicial. The proof showed that even though petitioner did not have an account in his name or in the name of the Waller Funeral Home at

[4] Petitioner does contend (Pet. 9–10) that the forgiveness by the Bank of a particular note was not income to him because he had not been liable on the note or, alternatively, that it had not been established that he had received an initial benefit for incurring the liability. But there was ample evidence that he was personally liable (R. 1328–1333, 1337–1339, 1533), and in the absence of evidence to the contrary the jury could reasonably infer that a benefit had been received in exchange for incurring the liability.

the Farmers Guaranty State Bank at Kennard (R. 211, 258), he made a practice, throughout the prosecution years, of writing checks on that bank as though he did have such an account (R. 256–260). The bank would hold these checks as cash items and then within a few days petitioner would redeem them, either with third party checks (usually checks written to the funeral home for professional services) or with cash (R. 256–260). The president of the bank testified that when a person writes a check against an account that does not exist, it is not an overdraft but a "hot check" (R. 258) and that the checks written by petitioner were in fact "hot checks," although the bank, knowing petitioner, nevertheless honored them (R. 259).

This banking practice facilitated petitioner's concealment of taxable income: the checks payable to the Waller Funeral Home used to redeem the "hot checks" represented, at least in part, items of income which petitioner instructed his bookkeeper not to record (see note 2, *supra*); by using these checks to redeem his "hot checks," petitioner prevented them from being recorded as a deposit to his own bank account and thereby hampered detection of the understatements on his returns.[3] Thus evidence of this practice was probative on the issue of willfulness; it showed that petitioner was handling his "affairs to avoid making the

[3] Some of the "hot checks" were admitted in evidence without objection by the defense (R. 186). Petitioner had admittedly destroyed others after they were redeemed (R. 1755). One hundred and seven checks paid in redemption of the "hot checks" were admitted in evidence without objection (R. 202–260).

records usual in transactions of the kind." *Spies* v. *United States*, 317 U.S. 492, 499.

3. There is no merit to petitioner's final contention (Pet. 14–16), that the government's expert witness should not have been permitted to express his opinion on nonaccounting issues. All such issues pertained to questions relating to taxation and the witness was qualified without objection to testify as an "expert witness in the income tax field" (R. 1464). Such witnesses are allowed wide latitude in criminal tax cases, as are experts testifying for the defense. *United States* v. *Johnson*, 319 U.S. 503, 519–520. But this witness, contrary to petitioner's suggestion (Pet. 15–16), did not state his conclusions on the whole case; it was left to the jury to resolve whether petitioner had been willful in understating his taxable income, and the witness expressed no opinion on that question.[6]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ERWIN N. GRISWOLD,
Solicitor General.

JANUARY 1973.

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[6] See, generally, Rule 704 of the new Federal Rules of Evidence: "Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact."

U.S. GOVERNMENT PRINTING OFFICE: 1973